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C O N F I D E N T I A L SECTION 01 OF 03 TOKYO 001997

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TAGS: [ECON](#) [ETRD](#) [EINV](#) [PREL](#) [JA](#) [TW](#) [CH](#)
SUBJECT: JAPAN-TAIWAN ECONOMIC TIES CENTERING ON
COOPERATION IN CHINA

TOKYO 00001997 001.2 OF 003

Classified By: CDA James P. Zumwalt. Reasons: 1.4 (b,d).

¶1. (C) Summary: Economic ties between Japan and Taiwan center increasingly on cooperative operations in mainland China, according to Embassy Tokyo contacts. The rapid improvement in the political relationship between Taipei and Beijing with the accession of the new Taiwan president took some in Tokyo by surprise, but the change has been welcomed. Warmer Beijing-Taipei ties may reduce Beijing's hostility to Japanese contact with Taiwan and facilitate expanded Japan-Taiwan relations. The complementary relationship between Taiwan and Japanese firms in China is likely to continue -- with strong support in both Tokyo and Taipei. However, as the relative advantages of China as a manufacturing platform begin to decline, the ability of the Taiwan authorities to leverage the China factor in their economic relations with Tokyo may diminish. End summary.

METI Cautious on Japan-Taiwan Business Links

¶2. (C) Taiwan is more of an economic complement to Japan than a competitor, according to METI Northeast Asia Division Director Shigeaki Tanaka. (Note: Tanaka was replaced by Hideto Akiba July 13 as part of METI's regular summer personnel transfers. End note.) Japanese industries utilize many modular parts from Taiwan manufacturers, which in turn also use a number of Japanese components. Tanaka noted a driving factor behind the concentration of Japanese manufacturers in the Yangtze Delta region around Shanghai is the fact that Taiwan component suppliers are clustered there as well. He speculated, if a sufficient number of Taiwan firms establish operations further inland in China, Japanese companies, who have been reluctant to set up operations there because of supply worries, might follow.

¶3. (C) Tanaka believes improved relations between Taiwan and the Mainland, notably the establishment of the so-called "three links," might actually slow Taiwan investment across the Strait. Taiwan is close enough physically to the Mainland that investment by Taiwan parts and material

manufacturers would not have been necessary had direct trade been possible. Once the three links are established, the incentive for further investment, at least in those industries, should decline.

14. (C) From a METI perspective, Taiwan investment in Mainland China has a problematic side in that Taiwan firms are too willing to transfer technology, often developed in cooperation with Japanese partners, to their mainland operations, Tanaka said. The consequence is a leakage of technology and manufacturing know-how through the resulting movement of personnel to other (Chinese) enterprises. METI also has concerns regarding Taiwan's own efforts to absorb Japanese technology. Tanaka cited the example of one Japanese material manufacturer that recently set up a plant in Taiwan for a product METI would have preferred stay in Japan. The main reason the Japanese firm did so, Tanaka observed, was probably the preferential tax treatment the Taiwan authorities had granted to the project.

15. (C) Tanaka indicated Japanese firms making new investments in China now focus increasingly on the domestic market, not on establishing export bases. Like Taiwan firms, Japanese firms focused on labor intensive operations in China have been hit by rising labor costs. Anecdotal evidence, however, shows they have responded in some cases with efforts to improve productivity among their Chinese workforce rather than relocating either to the Chinese interior -- as a number of Taiwan firms have -- or to lower wage countries like Vietnam. Tanaka noted the recent currency situation and outbreak of labor disputes in Vietnam soured impressions that that country is the easy alternative to China.

Improved Beijing-Taipei Ties May Facilitate Japanese

TOKYO 00001997 002.2 OF 003

Interaction with Taiwan

16. (C) Overall, Tanaka felt the change in administrations in Taiwan would make Japanese interaction with the Taiwan authorities easier and the reduction in tensions between Beijing and Taipei could ease the level of Chinese scrutiny of Taiwan's relations with third parties. Nevertheless, GOJ guidance on interaction with Taiwan authorities restricts meetings (including travel to Taiwan) to the director-general (assistant secretary equivalent) level, and, out of caution, METI generally does not go above the deputy director-general level. Tanaka had heard the Taiwan authorities had inquired whether the new economic affairs minister in Taipei could visit Tokyo, but the GOJ had made it clear no Japanese officials at either the minister or vice-minister levels would meet with him, which had discouraged the Taiwan authorities from further pursuing the request.

17. (C) Pressure from the Diet to enhance relations with Taiwan center on political, not economic issues, Tanaka said. Former METI Minister Takeo Hiranuma (2000-2003) is a major supporter of Taiwan and broached the idea of a trade agreement with Taiwan during his time at METI. Once Hiranuma left, enthusiasm for the idea waned and METI's focus shifted to the possibility of concluding smaller-scale agreements on specific issues such as IPR, investment facilitation, and harmonization of standards.

Tokyo Surprised by Rapid Improvement in Cross-Strait Relations

18. (SBU) In view of Fujitsu Research Institute economist Zhu Yan, the political significance of the new Taiwan administration overshadows the possible economic impact on Japan-Taiwan relations. The Japanese have been surprised by the rapid improvement in relations between Taiwan and China and by Taiwan President Ma's strong position regarding the Senkaku/Diaoyutai Islands. That Ma could deliver as quickly as he has on his promises to liberalize interaction with the

Mainland was unexpected in Tokyo. Zhu observed, however, steps Ma has taken on tourism, investment, and chartered flights are natural in light of the current economic ties between Taiwan and the Mainland. The previous DPP administration's unwillingness had been the main factor preventing their realization earlier.

Japan-Taiwan Partnership in China Operations Likely to Continue

¶9. (SBU) Within China, Japanese firms have generally followed in the footsteps of Taiwan companies, Zhu observed. The Japanese are much more comfortable dealing with Taiwan partners with whom they are likely to have established business relationships and whose corporate structures and cultures are similar to Japanese models. In general, because Japanese companies tend to have inherently conservative business strategies, have a relatively poor understanding of China, and tend to use expatriate Japanese as managers rather than providing opportunities for Chinese to advance, they quickly hit limits on their development in China. Teaming with a Taiwan partner active on the Mainland helps to ameliorate this situation. (Note: In apparent acknowledgement of this dynamic, the Interchange Association -- Japan's equivalent of AIT -- and the Taipei Economic and Cultural Representative Office in Japan have been holding seminars to promote an "alliance" for operations in China between small and medium Japanese firms and their Taiwan counterparts. One recent seminar provided survey data in Japanese on the Mainland jurisdictions most accommodating to Taiwan firms in order to assist Japanese entrepreneurs looking for possible Taiwan partners. End note.)

¶10. (SBU) Zhu believes the complementary relationship

TOKYO 00001997 003.2 OF 003

between Taiwanese and Japanese firms is likely to continue. He noted this phenomenon is not confined to China. Taiwan firms, which are more sensitive to increases in labor and other input costs than Japanese companies, had started to diversify their operations outside China as soon as wages and prices in traditional manufacturing bases like Guangdong's Pearl River Delta began to rise. Although none of China's interior provinces has yet to see a concentration of Japanese investment as has occurred around Shanghai, Zhu indicated such a development is possible as the Japanese companies' Taiwan suppliers begin to establish operations further inland.

¶11. (SBU) Japan also seems unlikely to take any near term steps that would affect this relationship, Zhu said. Japan's various economic partnership agreements, for example, which might have the potential to weaken the incentive to team with Taiwan firms by introducing preferential trade and investment conditions with other regional economies, have had little affect so far. Zhu speculated reviving the stalled Japan-South Korea FTA negotiations or the conclusion of an agreement between China and South Korea could affect Japan's economic ties with Taiwan, but neither agreement is likely in the foreseeable future.

Comment

¶12. (C) Taiwan was Japan's fourth largest export market in 2007 (after the U.S., China, and South Korea), according to GOJ customs statistics. Similarly, during that same year, Japan imported more from Taiwan than from Germany. Nevertheless, discussion in Tokyo of current economic relations between Taiwan and Japan inevitably turns to China. Although METI, concerned about maintaining Japan's edge in the face of China's rapid advances along the value chain, worries about Taiwan partners transferring sensitive technologies through their Mainland affiliates, powerful synergies appear to be driving this deepening Japan-Taiwan "alliance," which continues to expand even when both Taipei

and Tokyo have less than cordial relations with Beijing. So long as Japanese firms continue to resist recruiting and promoting local managers, their inclination to work with Taiwan partners in their China operations is unlikely to change. As labor and other input costs in China rise and new venues where Japanese firms have fewer relative disadvantages in dealing with the natives begin to beckon, the ability of the Taiwan authorities to "play the China card" in leveraging their economic relations with Tokyo may diminish.

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